

VZCZCXRO3025
PP RUEHDBU RUEHIK RUEHYG
DE RUEHBUL #1090/01 0931333
ZNR UUUUU ZZH

P 031333Z APR 07
FM AMEMBASSY KABUL
TO RUEHC/SECSTATE WASHDC PRIORITY 7266
INFO RUCNAFG/AFGHANISTAN COLLECTIVE
RUEKJCS/OSD WASHINGTON DC
RUEKJCS/Joint STAFF WASHINGTON DC
RHMFSS/CDR USCENTCOM MACDILL AFB FL
RHEHAAA/NATIONAL SECURITY COUNCIL WASHINGTON DC
RUEAIIA/CIA WASHINGTON DC
RHEFDIA/DIA WASHINGTON DC
RUCPDOC/DEPT OF COMMERCE WASHINGTON DC
RULSDMK/DEPT OF TRANSPORTATION WASHINGTON DC 0110
RHMCSS/FAA NATIONAL HQ WASHINGTON DC

UNCLAS SECTION 01 OF 03 KABUL 001090

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E.O. 12958: N/A

TAGS: BEXP EINV EAIR ECON AF

SUBJECT: ARIANA AFGHAN AIRLINE FINANCIAL CRISIS DEEPENS

Ref: 2006 Kabul 0883

This message is sensitive but unclassified--not for Internet distribution.

This message contains an action request; please see paragraphs 1 and ¶12.

SUMMARY

¶11. (SBU) Boeing recently notified the GoA that, absent immediate payment, it intends to terminate its lease contracts with Ariana for two B-757s on April 16; Ariana owes Boeing \$1.8 million in arrears on the contracts. Minister of Finance Ahady is reviewing his options for resolving the financial crisis, which include privatization or liquidation but for the moment do not include a GoA bailout; the USG is assisting with a consultant to help the MoF review Ariana's balance sheet. The immediate crisis is due in part to Ariana's inability to fly the 757s to Europe for safety and security reasons. The USG and other donors are helping to resolve these problems, but they will require considerable time to solve. The Embassy has been engaged with the GoA at a senior level to urge that it honor its commitments to Boeing. Embassy requests that the Department convey to Ambassador Jawad our expectation that any buyout or liquidation process be fair and transparent. End summary.

CRUNCH TIME ON BOEING LEASE

¶12. (SBU) In early March, Boeing issued default notifications for two B-757 aircraft leased by Ariana, with a deadline of March 30 for payment of \$1.8 million (reftel). No payment has been forthcoming, so on 30 March Boeing notified Ariana of its intent to terminate the lease agreement as of April 16. Boeing and the Ministry of Finance have established direct contact and are trying to arrange a venue and date for a face-to-face meeting to discuss the situation. Boeing initially rejected as too late a proposed meeting with Minister of Finance Ahady in the U.S. on April 10, when Ahady will be attending IMF and World Bank spring meetings. In a meeting with Embassy staff on April 1, Ahady indicated that he expects the April 10 meeting to happen.

¶13. (SBU) Ahady does appear to be trying in earnest to remedy the situation at Ariana and to be giving priority consideration to the Boeing obligations. (In our most recent meeting, Ahady observed that the Boeing lease has a sovereign guarantee clause, but that the lease's terms do not accord with Ariana's charter.) In mid-March, he asked the Cabinet for \$2 million to begin paying Ariana's most urgent debts, which the Cabinet declined to do. At the same time, Ahady approached the Embassy for assistance to the MoF in quantifying Ariana's assets and liabilities in order to clarify possible solutions to the financial crisis, including privatization or liquidation. USAID has supplied a contractor from its privatization team to do the review. Early last week, the Cabinet again declined a partial bailout for Ariana; it is scheduled to discuss the Ariana situation again on April 2.

¶14. (SBU) At Boeing's request, the Embassy engaged with the GoA and Ariana beginning in early March to urge them to find a way to honor their financial commitment to Boeing and to do so in a timely manner. We have made representations in support of Boeing at several meetings with Ahady, with Minister of Transportation and Civil Aviation Niamatullah Jawid, and with President of Ariana Abdul Mansoori. It is clear from these conversations that Ahady is trying to understand both the immediate financial situation at Ariana and the longer-term prospects for the airline's survival in order to take quick action. The USAID review of Ariana's balance sheet will certainly help with the first question, but the second will take longer to address.

SAFETY AND SECURITY PROBLEMS

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¶15. (SBU) At the root of Ariana's failure to produce revenue from the leased 757s are safety and security problems that prevent Ariana from flying between Afghanistan and Europe. Ariana originally intended to use the Boeing planes to fly to Frankfurt and London, but it has been blacklisted in the EU for safety problems for over a year. These problems reflect Ariana's own difficulties carrying out safe maintenance and operations, as well as the Ministry of Transportation and Civil Aviation's (MoTCA) inability to administer safety oversight. The USG and ICAO have worked on improving safety oversight for some time, but it will take several years before MoTCA is fully ICAO compliant.

¶16. (SBU) Ariana and Boeing had hoped to circumvent the safety shortfalls by having an ICAO-compliant company operate and maintain the aircraft under a third country's safety oversight. This was the reasoning behind having the airplanes operated by Eagle Aviation, a French company which falls under French oversight and which had been operating the 757s out of Dubai. However, the German airport police authority, which is responsible for approving the security regime for Germany-bound flights, has nixed the deal for security reasons. The German Ambassador has told the MoTCA that security conditions at Kabul International Airport are such that no commercial flight originating in Kabul may fly directly to Germany. As with safety issues, the security problems are many and severe, and they will take some time to cure. (NOTE: The Germans have unique insight into the security situation at Kabul International, since they are a primary provider of security assistance there. End note.)

¶17. (SBU) Between the safety and security problems, Ariana has little prospect of opening a direct route to Europe in the near future, and thus the economic logic of the 757 lease (and the follow-on purchase of four 737-700s) has crumbled. Neither Ariana nor Boeing seems to have faced up to this until very recently, in part because few understood the depth of Ariana's financial crisis.

A MEMORABLY UNLUCKY FORTNIGHT

¶18. (SBU) The events of the last two weeks have hardly been kind to Ariana. Shortly after Boeing issued its default notices, French

operator Eagle Aviation grounded the one aircraft it was operating for Ariana; the airline had failed to pay for \$2.5 million in operations charges accumulated since November. (Eagle had earlier leased back the other aircraft for its own charter and wet-lease operations to defray part of Ariana's obligations.) On March 22, the beleaguered president of Ariana, Abdul Ahad Mansoori, abruptly resigned. On March 23, one of Ariana's three Airbus A-300s--the only one still flying--ran off the runway in Istanbul and was damaged beyond repair, although luckily no one was injured. The same week, a UK arbitration decision found against Ariana for \$9.5 million in a contract dispute with a UK operations firm whose contract was apparently allowed to run uncancelled for a year, with no work being performed. Ariana's London lawyers will not move on an appeal until Ariana pays their fees, which are overdue and reportedly amount to nearly \$500,000. To finish this disastrous month, on March 31, one of Ariana's 727s clipped a parked Ariana 727's nose with its wingtip while taxiing in Kabul, damaging both airplanes and grounding them for the time being. This leaves Ariana with total of two flight-capable aircraft until it can repair the two damaged planes.

FINDING A WAY FORWARD

¶9. (SBU) In our latest meeting with Ahady on April 1, he was still groping for approaches to solve the problem. He indicated that a prospective buyer or buyers had expressed an interest in acquiring Ariana for \$20-30 million if the GoA will assume the airline's debts, provided both Boeing deals are still in place. At this juncture, Ahady is wondering whether these prospective deals make financial sense. With only rudimentary information so far on Ariana's assets and liabilities, and little sense of the profitability of the operations or the market value of assets such as ramp space, route structures, and the B-737 contracts, Ahady is finding it difficult to judge any offers that may present themselves. USAID's inventory of assets and liabilities should

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help, provided the information can be extracted from the thicket of unaudited and incomplete financial records at Ariana. After two weeks there, the consultant still does not have all the information he thinks is necessary to complete the review.

¶10. (SBU) While we have not heard the specific details, we have heard that Kabul Bank and the Alokozay company, both private sector Afghan interests, have separately expressed interest in buying Ariana. Ambassador Jawad in Washington has reportedly encouraged Boeing to open talks with Alokozay, a large Afghan trading company. Neither of these prospective buyers has presence or experience in aviation or transportation, so at this point it is difficult to judge the seriousness of the interest. Prospective bidders may well try to arrange an inside deal, as opposed to an open and transparent acquisition process.

COMMENT AND ACTION REQUEST

¶11. (SBU) Though the review of assets and liabilities is not yet complete, there seems to be little chance of anyone's discovering a trove of hidden value in Ariana. The airline now has two operating aircraft and a famously inefficient operation that employs 1,800 people. It owes at least \$14 million in immediate obligations and has a few routes serviced by aging and dangerously neglected airplanes. Though Ahady would clearly prefer to sell Ariana as a going operation, he also appears to be willing to consider liquidation. ("I just want it off my hands," was his exasperated expression at our last meeting.) The reality of Ariana's predicament is slowly sinking in, and at this point there seems to be little inclination within the Cabinet to rescue it as an ongoing state enterprise with an injection of GoA money.

¶12. (SBU) Whatever course this crisis follows, U.S. interest appears to lie in ensuring that the Boeing deals are not allowed simply to default without payment, and in ensuring that any buyout follows a

transparent process. At this point, we are agnostic on the question of whether Ariana should survive. Obviously the GoA will have to determine the wisdom of keeping its deals with Boeing alive, but that question is separable from the necessity of paying its existing obligations. The Embassy will continue to emphasize this point with the GoA. On the question of the transparency of any buyout or liquidation, in view of the rumors of Ambassador Jawad's lobbying with Boeing, we request that the Department make clear to Jawad that the USG strongly encourages the GoA to undertake a fair, transparent process. End comment and action request.

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